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Report to the Congress

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FINANCIAL AUDIT

Federal Financing Bank's 1993 and 1992 Financial Statements

GAO/AIMD-95-4

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General Accounting Office
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Accounting and Information Management Division

B-259368

December 6, 1994

To the President of the Senate and the
Speaker of the House of Representatives

This report presents the results of our review of the independent certified public accountants' audits of the Federal Financing Bank's (FFB) financial statements for the fiscal years ended September 30, 1993 and 1992. In the auditors' opinions, FFB's statements are fairly presented in all material respects in accordance with generally accepted accounting principles. The independent auditors' reports on FFB's internal accounting and administrative controls and on its compliance with laws and regulations are also provided. FFB's fiscal year 1993 financial statements reflect an accumulated deficit of over $2 billion. When we last performed an audit of FFB in 1988, we reported material weaknesses in FFB's internal control structure. The current auditors' reports indicate that material internal control weaknesses still exist.

Background

The Federal Financing Bank was created by the Federal Financing Bank Act of 1973. FFB was established to (1) finance federal and federally assisted borrowings in ways that least disrupt private markets, (2) coordinate such borrowing programs with the government's overall fiscal policy, and (3) reduce the costs of such borrowings from the public.

FFB provides financial assistance to or on behalf of federal agencies by (1) making direct loans to federal agencies to help them fund their programs, (2) purchasing loan assets from federal agencies, and (3) making direct loans to nonfederal borrowers (including foreign governments) that are secured by federal agency guarantees against risk of default by borrowers on loan principal and interest payments.

FFB obtains funds by borrowing from the Department of the Treasury. Each loan made by Treasury matches the terms and conditions, except for the interest rate, of the corresponding loans made by FFB. FFB charges its borrowers the interest it incurs on the Treasury borrowing, plus a fee of one-eighth of 1 percent to cover administrative costs.

Objectives, Scope, and Methodology

The Department of the Treasury contracted with two independent public accounting firms to perform audits of FFB's financial statements for fiscal years 1993 and 1992 as required by the Government Corporation Control

Act,[1] as amended by the Chief Financial Officers Act of 1990. Under the act, the Comptroller General may review any financial audit conducted by an external auditor. We elected to review FFB's 1993 and 1992 audits because we remain concerned about the long-standing internal control weaknesses that we reported on in our prior audits. In addition, FFB's financial statements still reflect a $2 billion deficit, which was first reported in 1989.

We conducted our review of the auditors' work between January 1994 and September 1994, in accordance with generally accepted government auditing standards. To determine the reasonableness of the auditors' work and the extent to which we could rely on it, we

- reviewed the auditors' approach and planning of the audits,
- evaluated the independence and qualifications of the audit staff,
- reviewed the financial statements and auditors' reports to evaluate compliance with generally accepted accounting principles and generally accepted government auditing standards, and
- reviewed and tested the auditors' working papers to determine (1) the nature, timing, and extent of audit work performed, (2) the extent of audit quality control methods the auditors used, (3) whether an understanding was obtained of the entity's internal control structure, (4) whether the auditors tested transactions for compliance with applicable laws and regulations, and (5) whether the evidence in the working papers supported the auditors' opinions on the financial statements and internal accounting control and compliance reports.

The Department of the Treasury provided comments on a draft of this report. These comments are presented in the Agency Comments section and are reprinted in appendix II.

FFB Accumulated Deficit Remains at $2 Billion

From 1985 to 1988, several FFB borrowers prepaid high interest rate loans made to them during 1980 and 1981 by FFB. While some of these borrowers prepaid their loans at the current Treasury market values, as required by FFB policy, specific legislation allowed others to prepay their loans at less than the current Treasury market value. As a result of accepting these loan prepayments at book rather than market value, FFB accumulated a deficit of $2 billion.

[1]Under the Federal Financing Bank Act of 1973, FFB is subject to the budget and audit provisions of the act, as amended. The act requires covered corporations to obtain financial statement audits in accordance with generally accepted government auditing standards.

A loan's current Treasury market value, as defined by FFB, is determined by calculating the net present value of the future stream of principal and interest payments the government gives up when FFB accepts the prepayment of a loan. When determining the current Treasury market value, FFB uses the current interest rate for a Treasury security with a comparable maturity. When a loan is prepaid by a borrower at its current Treasury market value, FFB experiences neither an economic gain nor a cost on the prepayment. In other words, FFB is no worse off by allowing a borrower to prepay its loan than if FFB held the loan to its original term and no loan default occurred.

Under specific legislation, FFB was required to accept the prepayment of certain loans at the book value[2] rather than the current Treasury market value. As a result, FFB incurred a cost of about $2 billion—the difference between the current Treasury market value and the book value of the prepaid loans. The legislation requiring FFB to accept certain loan prepayments at book value rather than market value did not change the prepayment terms of FFB's loan agreements with its borrowers and, consequently, the terms of FFB's borrowing agreement with Treasury. Therefore, FFB remains obligated to Treasury for the $2 billion difference between the current Treasury market value of the prepaid loans and the prepayment amounts FFB received. This $2 billion cost is currently reported as a deficit in FFB's financial statements.

We previously reviewed the cost of the loan prepayments and, in a 1989 report, suggested that, when requiring FFB to accept prepayments at book value, the Congress consider providing appropriations to the affected programming agencies or FFB to cover their cost.[3] We observed that if the Congress were to make appropriations to the affected program agencies, the costs of the prepayments would be reflected in the respective agencies' program budgets.

However, since our previous report, several significant provisions affecting the budget and appropriations process have been enacted. In particular, the Budget Enforcement Act of 1990 contains a provision placing discretionary spending caps on budget authority, allowing little or no growth in nominal dollar spending. These caps will become increasingly binding over the next several years, placing severe constraints

[2]A loan's book value is the unpaid principal balance plus accrued interest on the loan.

[3]Federal Financing Bank: The Government Incurred a Cost of $2 Billion on Loan Prepayments (GAO/AFMD-89-59, August 22, 1989).

on future appropriations, requiring consideration of other alternatives to eliminate FFB's prepayment liability.

While FFB has made payments to Treasury against the prepayment liability, interest has been accruing on the unpaid balance ($2,074,429,000 and $2,062,779,000 at September 30, 1993 and 1992) since the prepayment occurred in 1988. FFB's independent auditors indicated that it is unlikely that FFB's net interest income at its current rate will be sufficient to liquidate the prepayment liability. Without some mechanism to eliminate its debt, FFB is likely to carry its deficit indefinitely. In addition, Treasury is likely to carry its related receivable indefinitely.

FFB Made Few Improvements to Reported Internal Control Weaknesses

The FFB's independent certified public accountants' (IPA) internal control reports stated that while FFB has made some improvements in addressing specific internal control weaknesses, material weaknesses still exist in FFB's overall internal control structure. When we audited FFB's fiscal year 1988 financial statements, we reported material weaknesses in FFB's internal control structure, including deficiencies in reconciliations of accounting information and lack of maintenance of subsidiary ledgers for loans. Similarly, from fiscal years 1989 through 1992, the IPA who performed the financial statement audits reported material weaknesses regarding the inability of FFB to maintain subsidiary ledgers. And the IPA who performed the fiscal year 1993 audit again reported problems with reconciliations and maintenance of subsidiary ledgers. The IPA concluded that these material weaknesses in FFB's internal controls were caused by the lack of an effective core financial accounting system and problems in FFB's overall organizational structure.

FFB has been in the process of implementing a fully integrated accounting system for several years. While the new system is operational, the information in this system has not been reconciled with information in the existing accounting system. As a result, according to the IPA who performed FFB's 1993 audit, the new system is not used as FFB's core accounting system. Instead, two separate accounting systems are maintained by the administrative and credit accounting branches of FFB, resulting in duplication of effort in the preparation of financial information. In addition, because of a lack of clear accountability within the organizational structure, no steps are being taken to reconcile differences between the two systems.

The IPA recommended that Treasury give one individual the responsibility and authority to oversee both the credit accounting and administrative side of FFB to resolve the long-standing issues related to the new accounting system. We agree that this approach could mitigate some of the complications caused by FFB's fragmented structure. In response to the internal control letter, FFB officials indicated that they generally concurred with the IPA's findings. As of September 1, 1994, no corrective action had been taken by Treasury or FFB officials.

IPA Opinions on the Financial Statements

In the opinion of the IPAS, FFB's financial statements present fairly its financial position as of September 30, 1993 and 1992, the results of its operations, and the changes in its cash flows for the years then ended, in conformity with generally accepted accounting principles. The fiscal year 1993 report included a paragraph indicating that FFB will likely require appropriations and/or an increased interest rate margin charged to borrowers to finance its deficit caused by the waiver of $2 billion in prepayments.

In the IPA's fiscal year 1993 report on FFB's internal control structure, it reported two material weaknesses similar to those that other auditors had reported in previous years. The IPA for fiscal year 1993 also noted in its report on FFB's compliance with laws and regulations that FFB did not report these material weaknesses in its most recent FMFIA report, dated December 22, 1992.[4] Subsequent to the date of the IPA's opinion, FFB filed a management report for fiscal year 1993 disclosing these internal control weaknesses.

During our review, we found nothing to indicate that the IPAS' opinions on FFB's fiscal years 1993 and 1992 financial statements and reports on compliance with laws and regulations and internal controls are inappropriate or cannot be relied on.

During the course of their audits, the IPAS also identified several matters that, although not material to the financial statements, were communicated for FFB's consideration in a separate management letter.

[4]In commenting on this report, Treasury stated that FFB, as a government corporation and instrumentality of the United States, is not, strictly speaking, required to prepare and submit an FMFIA report. However, Treasury did recognize that the Government Corporation Control Act, as amended by the Chief Financial Officers Act of 1990, requires covered corporations to issue annual management reports. This report includes a statement on internal accounting and administrative control systems consistent with the requirements for agency statements on such systems under the Federal Managers' Financial Integrity Act of 1982.

We believe that the financial statements, together with the IPAs' opinions and our review of that work, provide the Congress with a dependable basis for evaluating FFB's financial position. This report presents FFB's financial statements and the auditors' opinions thereon. The independent auditors' reports on FFB's internal accounting controls and compliance with laws and regulations are also provided.

Recommendations

Because of the long-standing internal control weaknesses reported by the IPAs and previously by us, we support the IPA's recommendation that the Secretary of the Treasury appoint an individual with the responsibility and authority to oversee both the credit accounting and administrative functions of FFB.

Since FFB will not be able to repay its liability to Treasury associated with loan prepayments under its current operating scenario, Treasury should consider actions to eliminate this liability as well as the related account receivable on its books, including, if necessary, requesting appropriate legislation.

Agency Comments

In its written comments on a draft of this report, the Department of the Treasury generally agreed with our recommendations. Specifically, Treasury said it will continue to explore means to resolve the prepayment liability and is reviewing FFB's current structure to determine the most effective means of resolving the long-standing internal control issues. Treasury's written comments are included in appendix III.

We are sending copies of this report to the Chairmen of the Senate Committee on Governmental Affairs and the House Government Operations Committee, the Director of the Office of Management and Budget, the Secretary of the Treasury, and the Board of Directors of the Federal Financing Bank. Copies will also be made available to others upon request.

Please contact me at (202) 512-9406 if you or staff have any questions about this report.

Robert W. Gramling

Robert W. Gramling
Director, Corporate Financial Audits

Contents

Abbreviations

FFB	Federal Financing Bank
IPA	independent public accountant

Independent Auditor's Report for Fiscal Year 1993

Auditor's Opinion

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1801 K Street, N.W.
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Telephone 202 296 0800

Price Waterhouse

REPORT OF INDEPENDENT ACCOUNTANTS

To the Inspector General of the Department of Treasury
and Board of Directors of the Federal Financing Bank

We have audited the accompanying statement of financial position of the Federal Financing Bank (the Bank) as of September 30, 1993 and the related statements of operations and accumulated deficit, and of cash flows for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Bank for the year ended September 30, 1992 were audited by another independent accountant whose report dated March 31, 1993, expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements audited by us present fairly, in all material respects, the financial position of the Bank at September 30, 1993, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

In recent years, Congress has authorized certain Rural Electrification Administration-guaranteed borrowers and Department of Defense-guaranteed foreign military sales borrowers to prepay certain loans at their face (par) value, by, in effect, waiving the contractually required prepayment premiums. Premiums are frequently paid by borrowers to lenders when, upon prepayment, market interest rates are less than those stated in the loan agreements. Because the Bank is required to simultaneously liquidate the funds it borrowed from Treasury to finance these loans, and is required to pay a prepayment premium in doing so, notwithstanding the fact the borrowers'

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premium was waived, the Bank has suffered losses, and has accumulated a deficit of $2.1 billion as of September 30, 1993. It is unlikely that the Bank's net interest income at its current spread will be sufficient to liquidate the liabilities resulting from this deficiency as they become due. Therefore the Bank will likely require Congressional appropriations or an increased interest rate spread, or some combination thereof, to finance its deficit.

Price Waterhouse

March 25, 1994
Washington, D.C.

Auditor's Report on Internal Control Structure

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Price Waterhouse

REPORT ON INTERNAL CONTROL STRUCTURE

March 25, 1994

To the Inspector General of the Department of Treasury
and the Board of Directors of the Federal Financing Bank

We have audited the financial statements of the Federal Financing Bank (the Bank) as of and for the year ended September 30, 1993, and have issued our report thereon dated March 25, 1994.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of the Bank for the year ended September 30, 1993, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide reasonable assurance on the internal control structure.

The management of the Bank is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

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For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories:

- General ledger and financial reporting
- Loans, interest income, and interest receivable
- Borrowings, interest expense, and interest payable
- Debt Prepayment Premium
- Administrative expenses

For all of the internal control structure categories listed above, we obtained an understanding of the design of the relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The following reportable conditions were identified:

1. The Federal Financing Bank lacks an effective core financial accounting system, and;

2. The Federal Financing Bank lacks an organization structure which promotes accountability and empowers managers to take action on correcting weaknesses.

A material weakness is a condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We consider the two reportable conditions above to be material weaknesses. Our discussion of these material weaknesses forms the remainder of this report.

* * * * *

Finding 1: The Federal Financing Bank lacks an effective core financial accounting system.

Treasury's Financial Management Service is currently implementing an integrated financial accounting system for the Federal Financing Bank. Once fully implemented, the Loan Management Control System (LMCS), a mainframe system, will serve as the Bank's subsidiary ledger for loans and borrowings, and will calculate and accrue interest income and expense. The LMCS also will have full general ledger capability. At present, programming for the loans and borrowing modules is complete, and they can now calculate interest income, expense, and accruals. The general ledger application has not yet been fully programmed.

Although the subsidiary ledgers have been programmed, initial loading of information into them for all borrowers has not been completed, nor has the new information been reconciled to information contained in the Bank's spreadsheet-based system. Such a reconciliation is important because several agencies' loan balances show material differences between the previous, non-integrated records and LMCS; and for two agencies, loans are reported in summary only, and the detailed loan records have never been maintained by the Bank.

Because the data in LMCS does not reconcile to the data in the Credit Accounting Branch's spreadsheet records, and because the general ledger application is not complete, the Credit Accounting Branch does not use LMCS as its core accounting system. Instead, the Credit Accounting Branch maintains its own subsidiary ledgers in both PC-based spreadsheet and manual form, and uses manual journal vouchers to record information in the general ledger which is maintained on PC-based software. In effect, the Credit Accounting Branch duplicates every existing accounting function that LMCS does, including processing all payment information, not only in manual form but also, in some cases, automated spreadsheet format.

In June, 1993, the Bank's Administration branch made an effort to reconcile loan information in the general ledger to LMCS, and identified some differences. However, the remaining differences have not yet been fully resolved. For example, there is no effort underway to capture, in LMCS, the underlying detail regarding the loans for which the Bank maintains only agency totals instead of information for individual loans. Progress on completing the new general ledger system has been slow.

The problems in fully implementing the new system have several effects:

- Resources are being expended unnecessarily in maintaining duplicate sets of records, especially when each receipt is being recorded in a manual ledger, in addition to posting in LMCS.
- The control and management function is diminished because the spreadsheet environment takes substantially more effort to control and manually reconcile to cash records than the integrated system which automatically reconciles subsidiary ledgers to the general ledger.
- Relations between the Administration department and the Credit Accounting Branch are strained because of unclear direction for corrective action.

Clearly, the implementation of LMCS needs to be placed back on track. The recommendation which follows addresses the need to energize this effort. In a related second material weakness below, we address the related organizational and communication weaknesses that compound the system's weaknesses.

Recommendation:

We recommend that the President of the Bank take the following steps:

1. Task the management of the Bank with implementing LMCS as its core financial system, and terminating reliance on spreadsheet records, by an established deadline. We suggest September, 1994 for the implementation of LMCS as the subsidiary ledger for loans, borrowings, interest receivable, income, payable and expense: and September, 1995 for implementation of an integrated general ledger. It may be possible to implement the subsidiary ledger functions gradually before September 1994, one borrower at a time, once the balances have been reconciled for each borrower.

2. Ensure that the Bank's task force for implementation completes the following steps:

   - **Reconciliation of LMCS to non-integrated spreadsheets.** The reconciliation effort should identify at the specific loan level, the items which are different between LMCS and the spreadsheets. A hurdle to entering some loans to LMCS is the lack of supporting documentation. However, documented or not, cash flows relating to those loans are

being received, and the system will never integrate with Treasury's receipts records if those loans are not captured in LMCS. They may be flagged as undocumented loans in the system if necessary. The objective is to reflect all loans and related liabilities in the system. Once the differences have been identified at the loan level, they should be promptly resolved by the following steps 1) Research original documentation; 2) Compare actual interest/principal receipts to expected receipts; and 3) Confirm all loan balances with the related agency.

Secondly, loans where only agency totals exist must be addressed. Solutions include:

- Coordination with the related agency to download information from their systems into LMCS. The data should be "scrubbed" first, to format it for LMCS, and to identify problems with the data such as no-name accounts, missing fields, "plug" accounts or negative accounts.

- If for some reason downloading is not an option, for example if the borrowing agency only maintains manual records, then consider obtaining the manual records and entering the data in the LMCS, once again "scrubbing" the data as you go.

- If the data does not exist at the agency level either, the only option is to enter the loan balance in total at a weighted average interest rate, and account for differences in expected interest receipts on a monthly basis via journal vouchers.

The reconciliation effort will not yield a perfect result. There will be no-name accounts, accounts with fields missing such as termination or origination date, and other remaining unidentified differences with the borrowing agencies. These should not be allowed to hamper the reconciliation and integration effort and should not be permitted to absorb significant amounts of effort either in the implementation process or on a regular ongoing basis. The task force should define its plan of action for remaining unknowns:

- Agree on "guesses" for missing data such as dates, borrower name, etc. Document the decision and enter the guess in the system.

- Determine how much time will be spent further tracking an item, based on its materiality. At the end of the allotted time, the reconciler reports the efforts undertaken to the reconciliation task force. The task force makes a decision to make the change to LMCS and documents that decision.

At the end of the reconciliation effort, all of the Bank's outstanding loans will be in the system. This will be evidenced by the fact that pre-calculated interest receipts are in fact collected.

- **Switch-over to using the LMCS for revenue, expense, and accrual entries.** Once the LMCS is reconciled to non-integrated systems for each borrower, the switch to using it for revenue, expense and accrual entries should be simple. Credit Accounting Branch should run parallel to LMCS for one or two months using its spreadsheet application to ensure confidence in the LMCS data, then switch off the spreadsheet applications for calculating data.

- **Determine all the reasons why the Credit Accounting Branch believes it needs to maintain spreadsheet records.** It is certainly easy to work with data and perform analyses when the accountant has all the data needed in a simple spreadsheet, rather than having to rely on inquiry-only access to a mainframe system. The users of LMCS should identify all the reasons they may need a spreadsheet, and ensure that this functionality is readily available by on-line inquiry to LMCS, through a menu driven screen. The alternative approach of having convenient downloading access to LMCS, whereby accountants can easily obtain current information in spreadsheet software, should be explored -- but with a warning not to duplicate effort again. Ideally, LMCS should automatically produce all the information needed by the Bank to perform adequate accounting and control.

- **Complete development -- or acquisition -- of the general ledger application and integrate it with all other aspects of LMCS.** It is important that Credit Accounting Branch review all the journal entries to the general ledger for the past two or three years and ensure that the entries can easily be accomplished by the LMCS general ledger application. Once management is confident that the general ledger application is functioning properly, switch off the PC-based application.

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- **Ensure that relevant management and control reports are produced by the system.** Examples of management and control reports needed include the following:
    - Expected versus actual receipts by loan
    - New loans issued, loans terminated each month
    - Prepayment of loans
    - Monthly financial statements showing comparison to last year/month and to budget

The strategic plan should give an estimate of the resources expected to be spent on the effort, and be broken down into small, interim steps so that the tasks become manageable. The task force should meet as necessary and at least monthly.

3. The President should make a clear statement of commitment and expectation that LMCS will be implemented. The Bank's loan records should be reconciled to LMCS and LMCS implemented as the Bank's subsidiary ledger by September, 1994, and the subsidiary ledger should be fully integrated with a general ledger by September, 1995.

* * * * *

Finding 2: The Federal Financing Bank lacks an organization structure which promotes accountability and empowers managers to take action on correcting weaknesses.

At present, the Bank is organizationally fragmented. The Manager of the Credit Accounting Branch, who is responsible for maintaining key accounting records and preparing the Bank's financial statements, has no direct communications with the Bank's President. Any communications with the Bank's President, Secretary, or Treasurer must go through several other individuals, none of whom are assigned responsibility for the Bank. The Manager of Administration for the Bank, who is responsible for maintaining key information, does report to the Bank's President but has no other Bank personnel reporting to him. Further, communications between the Credit Accounting Branch and Administration is extremely strained and unproductive.

The weaknesses that have manifested as a result of this situation include:

- A lack of a fully coordinated effort to complete the LMCS, and fully reconcile information between the old and new systems. The lack of an integrated system such as LMCS causes Credit Accounting Branch staff to keep separate spreadsheet and manual records for information they should be obtaining from LMCS. They also recalculate considerable amounts of information that they should be able to access LMCS to obtain. In addition, they manually record all information in a general ledger application, including all payment information, in addition to using LMCS.

- Administration staff and Credit Accounting Branch having differing opinions about the accuracy of the financial information. For example, Administration's personnel place reliance on LMCS and not the PC-based general ledger, while Credit Accounting Branch personnel continue to rely on the PC-based general ledger application until the LMCS subsidiary ledger is fully integrated to the LMCS general ledger.

- Decreased day-to-day effectiveness of all of the Bank's managers -- Administration and Credit Accounting -- because of poor relationships between the two offices, as well as the absence of a fully integrated system.

Recommendation:

We recommend that the President of the Bank, along with the Secretary and the Treasurer, empower one individual within the Bank with the responsibility and authority to implement an integrated financial system for the Bank. This will require that both Administration and the Credit Accounting Branch report ***directly*** to this individual. We also recommend that the roles of the offices of the Bank be streamlined.

A good benchmark for an efficient organization structure is the one used by many commercial banks. The credit administration function -- daily, routine processing of information to LMCS -- should be performed by Administration. This would include:

- verifying adequate documentation and inputting new loans and corresponding borrowings
- accessing current applicable interest rates on the effective dates
- ensuring that accrual routines are functioning
- the calculation of Debt Prepayment Premium and processing to LMCS

The function of the Credit Accounting Branch should be streamlined to: 1) management and internal controls over the information in LMCS; 2) maintenance of the general ledger in accordance with generally accepted accounting principles; 3) preparing the standard Treasury financial reports; and 4) preparation of management and year-end financial reports. Credit Accounting Branch's functions would include the following:

- Ensuring appropriate cut-off of accrual and income transactions
- Ensuring proper posting of non-standard entries which would include recording debt prepayment premium and interest credit entries
- Reconciling cash transactions in the Treasury account
- Following up on a timely basis any interest not received or overdue principal
- Approving and processing any adjusting journal vouchers to the general ledger

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- Preparing the standard Treasury financial reports
- Initiating and coordinating the research of issues affecting disclosures necessary for the financial statements. In most cases, these require merely an information request from LMCS programmers, and in other cases, such as determining the future possible impact of new policies such as the debt prepayment premium or the interest credit program, they are multi-faceted tasks requiring the input of Legal Counsel, Treasury management, and others.
- Preparing monthly management reports for executive management meetings.
- Preparing the year-end financial statements
- Management and resolution of any other weaknesses as they arise.

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Status of prior year's material weaknesses

The following material weaknesses were reported to the Federal Financing Bank by another independent auditor in a report dated March 31, 1993:

MATERIAL WEAKNESS		CURRENT STATUS
1	Cash transactions were recorded in the general ledger more than 30 days after the transaction had occurred.	This condition still exists. The reason cited for the delay is that cash transactions are posted to Credit Accounting Branch's spreadsheet records in batch mode once a month. We consider this condition to be an example of inefficiencies caused by not having an efficient accounting system. Once the integrated system is fully implemented, as noted in recommendation 1 above, accounts can be updated daily.
2	A subsidiary is not maintained for Small Business Administration/Local Development Corporation (SBA/LDC) loans.	This weakness still exists. This is one of the reasons why LMCS is not ready to be utilized as a core accounting system. Our recommendations regarding this weakness are addressed in recommendation 1 above.
3	A subsidiary ledger in an acceptable format is not maintained for debt owed to Treasury.	The borrowings subsidiary ledger and the loans subsidiary ledger are one and the same thing. It would be redundant to duplicate the loans system to create a borrowings system. This weakness exists, however, because the loans system is not yet operational, as we discussed in recommendation 1 above.
4	Subsidiary ledgers and commitment ledgers are not adequately maintained.	This weakness relates to the lack of reconciliation of data in the spreadsheet applications to the general ledger. This condition still exists and must be resolved by implementing LMCS as the Bank's core accounting system, as recommended in 1 above.

* * * * *

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above.

In addition to the material weaknesses we identified, we noted certain matters involving the internal control structure and its operation that we have reported to the management of the Bank in a separate letter.

This report is intended for the information of the Office of Inspector General and the Board of Directors and Management of the Federal Financing bank, and the Congress. However, this report is a matter of public record and its distribution is not limited.

Price Waterhouse

March 25, 1994
Washington, D.C.

Auditor's Report on Compliance With Laws and Regulations

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Telephone 202 296 0800

Price Waterhouse

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

To the Inspector General of the Department of Treasury
and the Board of Directors of the Federal Financing Bank

We have audited the financial statements of the Federal Financing Bank (the Bank) as of and for the year ended September 30, 1993, and have issued our report thereon dated March 25, 1994.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws and regulations applicable to the Bank is the responsibility of the Bank's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Bank's compliance with certain provisions of applicable laws and regulations. However, the objective of our examination of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The Federal Managers' Financial Integrity Act of 1982 (FMFIA) requires that the head of each agency reports annually to the President of the United States and the Congress that the agency's systems of internal accounting and administrative control fully comply with internal control standards established by the U.S. Office of Management and Budget. Alternatively, the agency must report any material weaknesses in the agency's systems of internal accounting and administrative control, along with plans and a schedule for correcting such weaknesses. The passage of the Chief Financial Officers Act of 1990 made these requirements applicable to the Bank. In our report on the Bank's internal control structure dated March 25, 1994, we identified two material weaknesses. These material weaknesses were not reported in the Bank's most recent FMFIA report dated December 22, 1992.

Report on Compliance with Laws and Regulations
Page 2

Except for the condition stated in the fourth paragraph above, the results of our tests indicate that, with respect to the items tested, the Bank complied, in all material respects, with the provisions referred to in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that the Bank had not complied, in all material respects, with those provisions.

This report is intended for the information of the Inspector General of the Department of Treasury, the Board of Directors and management of the Bank, and the Congress. However, this report is a matter of public record and its distribution is not limited.

Price Waterhouse

March 25, 1994
Washington, D.C.

Financial Statements

FEDERAL FINANCING BANK
STATEMENT OF FINANCIAL POSITION
AS OF SEPTEMBER 30, 1993 and 1992
(in thousands)

	1993	1992
ASSETS		
Funds with U.S. Treasury	$338,125	$338,165
Loans receivable - net (Note 2)	129,430,651	164,503,561
Accrued interest receivable	2,794,094	3,345,220
Accounts receivable	8	418
Total assets	$132,562,878	$168,187,364
LIABILITIES AND ACCUMULATED DEFICIT		
Borrowings (Note 3)	$129,426,116	$164,499,353
Accrued interest payable	3,118,583	3,630,696
Debt prepayment premium (Note 4)	2,074,429	2,062,779
Other liabilities	313	2,900
Total liabilities	134,619,441	170,195,728
Accumulated deficit	(2,056,563)	(2,008,364)
Total liabilities and accumulated deficit	$132,562,878	$168,187,364

The accompanying notes are an integral part of these financial statements.

1

FEDERAL FINANCING BANK
STATEMENT OF OPERATIONS AND ACCUMULATED DEFICIT
FOR THE YEARS ENDED SEPTEMBER 30, 1993 and 1992
(in thousands)

	1993	1992
Interest on loans	$11,349,539	$14,696,128
Interest on borrowings	(11,246,969)	(14,503,760)
Net interest income	102,570	192,368
Administrative expenses	(2,316)	(2,496)
Net income before extraordinary item	100,254	189,872
Extraordinary loss on Debt prepayment premium	(148,453)	(86,717)
Net (loss) income	(48,199)	103,155
Accumulated deficit - beginning of the year	(2,008,364)	(2,111,583)
Prior period adjustment	0	64
Accumulated deficit - end of the year	($2,056,563)	($2,008,364)

The accompanying notes are an integral part of these financial statements.

2

FEDERAL FINANCING BANK
STATEMENT OF CASH FLOWS
FOR THE YEARS ENDED
SEPTEMBER 30, 1993 AND 1992
(in thousands)

	1993	1992
CASH FLOWS FROM OPERATIONS		
Net (loss) income	($48,199)	$103,155
Adjustments to reconcile net (loss) income to net cash provided:		
Prior period adjustment		64
Discount amortization	(2,129)	(634)
Decrease in accounts receivable	410	0
Decrease in accrued interest receivable	551,126	1,027,848
(Decrease) in accrued interest payable	(512,113)	(1,017,626)
Increase (decrease) in debt prepayment premium	11,650	(42,955)
(Decrease) increase in other liabilities	(2,587)	2,151
Net cash (used in) provided by operations	(1,842)	72,003
CASH FLOWS FROM INVESTING ACTIVITIES		
Loan disbursements	(188,796,383)	(358,280,103)
Principal collections	223,891,358	388,080,666
Net cash provided by investing activities	35,094,975	29,800,563
CASH FLOWS FROM FINANCING ACTIVITIES		
Advances	188,796,383	358,277,887
Repayments of advances	(223,889,556)	(388,152,180)
Net cash used in financing activities	(35,093,173)	(29,874,293)
Net decrease in cash	($40)	($1,727)
Cash - beginning of the year	$338,165	$339,892
Cash - end of the year	$338,125	$338,165

The accompanying notes are an integral part of these financial statements.

3

FEDERAL FINANCING BANK
Notes to the Financial Statements
September 30, 1993 and 1992

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Federal Financing Bank (the Bank) was created by the Federal Financing Bank Act of 1973 (12 USC 2281) as an instrumentality of the U. S. Government. Although originally created as an off-budget entity, the Bank was subsequently placed on-budget by Public Law 99-171. The Bank was established to assist and coordinate agency borrowing and guaranteed borrowing to reduce the cost to the federal government of some of its borrowing operations. The Bank has authority to purchase agency debts and guaranteed obligations from a federal agency and to finance these transactions by borrowing from the Treasury or the public.

Basis of Accounting

The financial statements are prepared in accordance with generally accepted accounting principles, and therefore are presented on the accrual basis of accounting.

Funds with U.S. Treasury

As a federal government corporation, the Bank maintains a fund balance with the U.S. Treasury and does not hold cash. For the purposes of the Statement of Cash Flows, the funds with the U.S. Treasury are considered cash.

Debt Prepayment Premium

The nature of the Debt Prepayment Premium is discussed in detail in Note 4. The Debt Prepayment Premium is calculated as the difference between 1) the face amount of the Treasury borrowing being prepaid, which is the amount the Bank receives in prepayment proceeds, and 2) the present value of the expected future cash flows under the original terms, discounted at Treasury's rate at the prepayment date, which is the amount the Bank must pay to Treasury in order to prepay the debt.

Interest Rates on Loans

Except as discussed in Notes 2 and 4, the Bank's policy is to charge its borrowers an interest rate that is equivalent to one-eighth of one percent more than the rate Treasury would pay on a security having a comparable maturity and payment schedule, as estimated by Treasury. The income resulting from the one-eighth of one percent was designed to cover the Bank's administrative expenses, and to provide equity.

FEDERAL FINANCING BANK
Notes to the Financial Statements
September 30, 1993 and 1992

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowances for Loan Losses

The Bank does not establish an allowance for loan losses because loan principal and interest are guaranteed by federal agencies and are backed by the full faith and credit of the U.S. Government. Direct loans to the Tennessee Valley Authority (TVA) and United States Postal Service (USPS) are exceptions since they are not guaranteed by the United States. However, no allowance for loan losses was required for TVA and USPS as of September 30, 1993.

Related Parties

The Bank is subject to the general supervision and direction of the Secretary of the Treasury. As provided by law, the Secretary of the Treasury acts as Chairman of the Board of Directors. The Bank's management functions are performed by employees of Treasury's Departmental offices; its legal counsel is Treasury's General Counsel; and, its accounting operations are conducted by Treasury's Financial Management Service (FMS). The Bank reimburses Treasury for facilities and services. As stated in Note 8, the U.S. Office of Personnel Management administers and is liable for the Bank's employee benefit programs.

2. LOANS RECEIVABLE

Loans receivable include agency loans purchased, direct loans to agencies, and loans to nonfederal entities, the repayment of which is guaranteed by another federal agency. Agency loans purchased are either notes or pools of loans sold by federal agencies in the form of certificates representing shares of ownership in the loan pool. The selling agencies guarantee the principal and interest repayments on the notes or certificates. Direct loans to agencies are debt securities issued to the Bank by agencies that are authorized by Congress to borrow to finance their activities.

FEDERAL FINANCING BANK
Notes to the Financial Statements
September 30, 1993 and 1992

2. *LOANS RECEIVABLE (CONTINUED)*

Loans to nonfederal entities are loans made to nonfederal borrowers whose obligation to repay the principal and interest is guaranteed by a federal agency. Loans receivable consists of the following (dollars in millions):

Agency	September 30,	
Agency Loans Purchased:	1993	1992
Farmers Home Administration	$38,619	$42,979
Medical Facilities, Department of Health and Human Services (HHS)	54	69
Less: Unamortized Discount	(3)	(5)
Health Maintenance Organizations, HHS	33	60
Rural Electrification Administration (REA)	4,599	4,599
Small Business Administration - Local Development Companies (SBA-LDC)	3	5
Total Agency Loans Purchased:	43,305	47,707
Direct Loans to Agencies:		
Export-Import Bank of the U.S.	5,795	7,692
Tennessee Valley Authority	6,325	7,175
Resolution Trust Corporation	31,688	46,535
Federal Deposit Insurance Corporation	0	10,160
U.S. Postal Service	9,731	9,903
Total Direct Loans to Agencies	53,539	81,465

FEDERAL FINANCING BANK
Notes to the Financial Statements
September 30, 1993 and 1992

2. LOANS RECEIVABLE (CONTINUED)

Agency	September 30,	
Guaranteed Loans to Nonfederal Entities:	1993	1992
Foreign Governments, Defense Security Assistance Agency	4,083	4,344
General Services Administration	1,586	774
Plus: Capitalized Interest	102	82
Guam Power Authority, Department of Interior	0	27
Community Development Block Grants, Department of Housing and Urban Development (HUD)	131	174
Low Rent Public Housing, HUD	1,801	1,853
Ship Leasing, Department of Defense, Navy	1,528	1,576
Rural Utilities, REA	17,653	18,142
State/Local Development-503, SBA	576	634
Small Business Investment Corporation, SBA	90	143
Seven States Energy Corporation, Tennessee Valley Authority	0	2,417
Student Loan Marketing Association, Department of Education	4,790	4,820
Virgin Islands, Department of Interior	23	24
Washington Metro Area Transit Authority, Department of Transportation (DOT)	177	177
Railways 511, DOT	17	19
Rhode Island Depositors Economic Protection Corporation, Department of Treasury	30	125
Total Guaranteed Loans to Nonfederal Entities	32,587	35,331
Total Loans Receivable	$129,431	$164,503

Congress enacted laws allowing the Rural Electrification Administration (REA) to pay less interest to the Bank than stated in its contractual agreements, based on REA's receipts from its borrowers. The Bank has no recourse against REA and must absorb the cost of this foregone interest, because the Bank must pay the full amount of interest on its underlying borrowings to Treasury.

FEDERAL FINANCING BANK
Notes to the Financial Statements
September 30, 1993 and 1992

2. *LOANS RECEIVABLE (CONTINUED)*

As a result of this policy, the Bank incurred foregone interest of $80.3 million in fiscal year 1993, which was the first year of this policy. The impact of this policy reduces the value of the REA loans; however, an allowance has not been recorded on the balance sheet as of September 30, 1993 because the future impact of this policy can not be predicted. Based on the shortfall in interest income in fiscal year 1993, the face value of the related loans of $22,252 million would be written down by an allowance of approximately $830 million, if the shortfall were to continue in the future in the same proportion as in fiscal year 1993.

3. *BORROWINGS*

The Bank finances its loan portfolio primarily by borrowing from the Treasury. Under the Federal Financing Bank Act of 1973, the Bank may, with the approval of the Secretary of the Treasury, borrow without limit from the U.S. Treasury. At September 30, 1993, the Bank had outstanding advances owed to Treasury of $114.3 billion, with interest rates ranging from 2.881 percent to 16.305 percent, and maturity dates from October 1, 1993 to September 30, 2026.

Additionally, the Bank had outstanding borrowings of $15.0 billion from the Civil Service Trust Fund, which is administered by the Office of Personnel Management. These borrowings are at interest rates ranging from 8.75 percent to 9.25 percent, and with maturity dates ranging from June 30, 2003 to June 30, 2005.

At September 30, 1993, principal installments due on borrowings are as follows (in billions):

Fiscal Year	Amount
1994	$38.7
1995	9.7
1996	11.8
1997	6.6
1998	6.9
1999-2026	55.7
Total	$129.4

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FEDERAL FINANCING BANK
Notes to the Financial Statements
September 30, 1993 and 1992

3. BORROWINGS (CONTINUED)

Payments due on borrowings are paid when principal collections on loans receivable are received. To the extent such loan proceeds are not sufficient to repay the debt, the Bank utilizes accumulated earnings received on loans. If accumulated earnings are not sufficient to repay the debt, the Bank can continue to operate using its unlimited borrowing authority with Treasury. However, borrowings to finance accumulated deficits will have to be eventually repaid either by raising the interest spread or through appropriations. The amount of interest paid in fiscal years 1993 and 1992 was $11.9 billion and $15.5 billion, respectively.

4. DEBT PREPAYMENT PREMIUM

Under the terms of its master promissory note with Treasury, the Bank must liquidate its borrowings with Treasury at the same time as loans receivable financed by those borrowings are liquidated. To avoid unusual gains or losses, the Bank's normal policy is to match the maturity and, except for a one eighth of one percent spread, the interest rate on its loans receivable with those of its borrowings. In addition, for most of its loans, premiums or discounts resulting from loan prepayments are equivalent to the premiums or discounts the Bank paid or received when it simultaneously prepaid its Treasury borrowings. Premiums or discounts arise to the extent market interest rates at the prepayment date differ from rates stated in the loan agreements. The effect of these policies is to mitigate the Bank's risk from interest rate fluctuations.

However, Congress authorized certain borrowers having loans guaranteed by the Rural Electrification Administration (REA) to prepay their loans at par (outstanding balance) rather than market value up to a specified dollar limit. Further, legislation also authorized borrowers in the foreign military sales program guaranteed by the Defense Security Assistance Agency (DSAA) to prepay, at par, certain loans meeting specific criteria. The effect of these statutes was to waive payment of premiums to the Bank, which would otherwise have resulted from the fact that interest rates at the dates of prepayment were less than the rates in the loan agreements. Because the Bank's agreement with Treasury required it to simultaneously liquidate the funds it borrowed to finance these loans, and to pay a premium in doing so, notwithstanding the fact that the borrowers' premiums were waived, the Bank suffered losses. The Bank incurred costs of $148 million and $87 million in fiscal years 1993 and 1992, respectively, as a result of prepayments under these statutes. These costs have been recorded as extraordinary losses in the Statement of Operations. The cumulative cost incurred by the Bank as a result of this legislation is $2,506,269,509 through September 30, 1993.

FEDERAL FINANCING BANK
Notes to the Financial Statements
September 30, 1993 and 1992

5. *COMMITMENTS AND CONTINGENCIES*

Almost all of the Bank's loans are to federal agencies or to private sector borrowers whose loans are guaranteed by a federal agency. When an agency has to honor its guarantee because a borrower defaults, that agency must obtain an appropriation or use other resources to pay the Bank. However, if an appropriation is not granted or federal agencies are not allowed to fund the losses by borrowing from the Treasury, and the Bank is legislatively required to absorb the debt the agency owes it, the Bank would incur a loss. Since the bank is unable to estimate the amounts of the probable losses which might result from default, no charge for contingencies against fiscal year 1993 income has been recorded.

As of September 30, 1993 and 1992 there were $131.4 billion and $166.5 billion, respectively, of loan commitments.

6. *ACCUMULATED DEFICIT*

The liability for the principal amount of loan prepayments as described in Note 4 above was $2,069,368,220 and $2,057,195,943 respectively for fiscal years 1993 and 1992. Due to the legislation pertaining to loan prepayments by the Rural Electrification Administration (REA) and the Defense Security Assistance Agency (DSAA), the Bank has incurred losses amounting to $148,453,170 for 1993 and $86,717,628 for 1992. The recurring accumulated deficits incurred by the Bank are due to these losses. While the Bank has been able to make payments against the debt prepayment liability, it also had to pay the interest accruing on the liability. Currently, the Bank is earning interest from borrowers equivalent to one eighth of one percent more than the rate that is due Treasury on a particular security. It is unlikely that the net interest earnings at the current spread will be sufficient to liquidate the liabilities resulting from the accumulated deficit. Therefore the Bank will likely require Congressional appropriations, or an increased interest rate spread, or some combination thereof, to finance its deficit.

7. *PRIOR PERIOD ADJUSTMENTS*

Prior period adjustments of $64,000 were made for the year ended September 30, 1992, for previously unrecorded capitalized interest on GSA loan programs, Foley Court, Foley Square, and Foley Office Building.

FEDERAL FINANCING BANK
Notes to the Financial Statements
September 30, 1993 and 1992

8. PENSIONS AND ACCRUED ANNUAL LEAVE

Virtually all of the employees whose salary cost is allocated to the Bank by Treasury are covered by either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). For CSRS employees, Treasury withholds a portion of their base earnings. The employees' contributions are then matched by Treasury and the sum is transferred to the Civil Service Retirement Fund, from which the CSRS employees will receive retirement benefits. For FERS employees, Treasury withholds, in addition to social security withholdings, a portion of their base earnings. Treasury contributes an amount proportional to the employees' base earnings towards retirement, and in addition a scaled amount towards each individual FERS employee's Thrift Savings Plan, depending upon his/her level of savings. The FERS employees will receive retirement benefits from the Federal Employees Retirement System, Social Security System and the Thrift Savings Plan deposits that have accumulated in their accounts.

Although Treasury funds a portion of pension benefits under the Civil Service and Federal Employees Retirement Systems relating to its employees and makes the necessary payroll withholdings from them, it has no liability for future payments to employees under these programs and does not account for the assets of the Civil Service and Federal Employees Retirement Systems nor does it have actuarial data with respect to accumulated plan benefits or the unfunded pension liability relative to its employees. These amounts are reported by the Office of Personnel Management (OPM) for the Retirement Systems and are not allocated to the individual employers. OPM also accounts for health and life insurance programs for retired civilian federal employees. Similar to the accounting treatment afforded the retirement programs, the actuarial data related to the health and life insurance programs is maintained by OPM and is not available on an individual employer basis.

FEDERAL FINANCING BANK
Notes to the Financial Statements
September 30, 1993 and 1992

9. *FAIR VALUE OF FINANCIAL INSTRUMENTS*

The estimated values of each class of financial instrument for which it is practicable to estimate a fair value at September 30, 1993 are as follows (dollars in thousands);

As of September 30,1993	Carrying Value	Fair Value
Funds with U.S. Treasury	$338,125	$338,125
Loans receivable-net	129,430,651	154,702,436
Accrued interest receivable	2,794,094	2,794,094
Accounts receivable	8	8
Borrowings	(129,426,116)	(154,244,020)
Accrued interest payable	(3,118,583)	(3,118,583)
Debt prepayment premium	(2,074,429)	(2,074,429)
Other liabilities	(313)	(313)

The methods and assumptions used to estimate the fair value of each class of financial instrument are described below.

Funds with U.S. Treasury

The carrying amount approximates fair value because of the liquid nature of the Funds with Treasury.

Loans Receivable and Borrowings

The fair value of Loans Receivable is estimated by discounting the future cash flows using the September 30, 1993 rates at which similar loans would be made to borrowers for the same remaining maturities. The fair value of borrowings is estimated using the same calculation as the fair value of loans using the borrowing rate which is one eighth of one percent lower than the lending rate. The effects of any future policy changes to permit additional prepayment premiums or waivers of interest have not been considered in estimating fair value.

Accrued Interest Receivable, Accounts Receivable, Accrued Interest Payable, and Other Liabilities

These assets and liabilities are stated on the balance sheet at the amount expected to be realized or paid.

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FEDERAL FINANCING BANK
Notes to the Financial Statements
September 30, 1993 and 1992

9. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Debt Prepayment Premium

The Debt Prepayment Premium represents a liability to Treasury under an indefinite borrowing agreement. There are no specified repayment terms and the interest rate is fixed at the prepayment date. For the purposes of estimating its fair value, it has been treated as payable on demand and is considered to be stated on the balance sheet at its fair value.

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Independent Auditor's Report for Fiscal Year 1992

Auditor's Opinion

GKW GREGORY K. WASHINGTON
CERTIFIED PUBLIC ACCOUNTANT

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Federal Financing Bank

I have audited the accompanying combined statements of financial position of the Federal Financing Bank as of September 30, 1992 and September 30, 1991, and the related combined statements of income and retained earnings and combined statements of cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with generally accepted auditing standards and generally accepted government auditing standards (GAO's Government Auditing Standards, 1988 Revision). Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audit provides a reasonable basis for my opinion.

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Federal Financing Bank as of September 30, 1992 and September 30, 1991, and the results of its operation and its cash flow for the years then ended, in conformity with generally accepted accounting principles.

MARCH 31, 1993
LANDOVER, MD

Greg K. Washington, CPA
GREGORY K. WASHINGTON, CPA

Financial Statements

FEDERAL FINANCING BANK
COMBINED STATEMENT OF FINANCIAL POSITION
AS OF SEPTEMBER 30, 1992 AND 1991

ASSETS	As of September 30, 1992 (in thousands)	1991
Funds with U.S. Treasury	$ 338,165	$ 339,892
Loans receivable - net (Notes 2,5,& 6)	164,503,561	194,304,124
Accrued interest receivable	3,345,220	4,373,068
Accounts receivable	418	418
Total assets	$168,187,364	$199,017,502
LIABILITIES AND ACCUMULATED DEFICIT		
Borrowings (Note 3)	$ 164,499,353	$ 194,374,280
Accrued interest payable (Note 3)	3,630,696	4,648,322
Debt prepayment premium (Notes 4, 5, & 8)	2,062,779	2,105,734
Other liabilities	2,900	749
Total liabilities	170,195,728	201,129,085
Commitments and contingencies (Note 5)	0	0
Accumulated deficit (Note 8)	(2,008,364)	(2,111,583)
Total liabilities and accumulated deficit	$ 168,187,364	$ 199,017,502

SEE NOTES TO FINANCIAL STATEMENTS

2

FEDERAL FINANCING BANK
COMBINED INCOME STATEMENT
FOR THE YEARS ENDED SEPTEMBER 30, 1992 AND 1991

	September 30, 1992 (in thousands)	September 30, 1991 (in thousands)
Interest on loans (Note 6)	$ 14,696,128	$ 16,938,107
Interest on borrowings (Note 6)	14,503,760	16,718,425
Net interest income	192,368	219,682
Less: Administrative expenses	(2,496)	(2,438)
Net income before extraordinary item	189,872	217,244
Extraordinary items:		
Debt prepayment premium (Note 4)	86,717	273,370
Net income (loss)	103,155	(56,126)
Retained earnings (accumulated deficit) beginning of the year	(2,111,583)	(2,084,512)
Prior period adjustment (Note 7)	64	29,055
Transfers to the U.S. Treasury	0	0
Accumulated deficit end of the year (Note 8)	$(2,008,364)	$(2,111,583)

SEE NOTES TO FINANCIAL STATEMENTS

3

FEDERAL FINANCING BANK
COMBINED STATEMENT OF CASH FLOWS
FOR THE YEARS ENDED
SEPTEMBER 30, 1992 AND 1991

	September 30, 1992	1991
	(in thousands)	
CASH FLOWS FROM OPERATIONS:		
Net income (loss)	$ 103,155	$(56,126)
Adjustments to reconcile net income (loss) to net cash provided:		
Prior period adjustment	64	29,055
Decrease (increase) in accounts receivable	0	84
Decrease (increase) in accrued interest receivable	1,027,848	423,870
Increase (decrease) in accrued interest payable	(1,017,626)	(439,288)
Increase (decrease) in prepayment premium	(42,955)	42,292
Increase (decrease) in other liabilities	2,151	32
Discount amortization	(634)	(616)
Net cash from operations	72,003	(697)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Loan disbursements	(358,280,103)	(269,943,161)
Principal collections	388,080,666	249,029,064
Net cash from investing activities	29,800,563	(20,914,097)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Advances	358,277,887	269,943,161
Repayments of advances	(388,152,180)	(249,027,871)
Net cash from financing activities	(29,874,293)	20,915,290
Net increase (decrease) in cash	(1,727)	496
Cash -- beginning of the year	339,892	339,396
Cash -- end of the year	$ 338,165	$ 339,892

SEE NOTES TO FINANCIAL STATEMENTS

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FEDERAL FINANCING BANK
NOTES TO THE COMBINED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Federal Financing Bank ("Bank") was created by the Federal Financing Bank Act of 1973 (12 USC 2281) as an instrumentality of the U.S. Government. Although originally created as an off-budget entity, the Bank was subsequently placed on-budget by Public Law 99-171. The Bank was established to assist and coordinate agency borrowing and guaranteed borrowing to reduce the cost to the federal government of some of its borrowing operations. The Bank has authority to purchase agency debts and guaranteed obligations from a federal agency and to finance these transactions by borrowing from the Treasury or the public.

Basis of Accounting

The financial statements are prepared in accordance with generally accepted accounting principles, and therefore are presented on an accrual basis.

Interest Rates on Loans

The Bank charges its borrowers an interest rate that is equivalent to one-eighth of one percent more than the rate the Treasury would pay on a security having a comparable maturity and payment schedule, as estimated by Treasury. The income resulting from the one-eighth of one percent is used to cover the Bank's administrative expenses.

Allowances for Loan Losses

The Bank does not establish an allowance for loan losses because loan principal and interest are guaranteed by the federal agencies and are backed by the full faith and credit of the U.S. Government. Direct loans to the Tennessee Valley Authority (TVA) and the United States Postal Service (USPS) are exceptions since they are not guaranteed by the United States. However, no allowance for loan losses was required for TVA and USPS as of September 30, 1992.

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FEDERAL FINANCING BANK
NOTES TO THE COMBINED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

Retained Earnings Transferred to the U.S. Treasury

In August 1981, the Board of Directors authorized the Bank's Treasurer to pay to the General Fund of the Treasury, as soon as practicable after each calendar quarter, any cash in excess of the amount required to cover contingency and operating expenses. The amount of contingency reserve as determined by the Bank's Treasurer and its Vice President was $1 million.

Transfers totaled $200 million in fiscal year 1987. However, due to accumulated losses resulting from par prepayment of certain bank loans as authorized by Congress, no transfers have been made for fiscal years 1988 through 1992.

Related Parties

The Bank is subject to the general supervision and direction of the Secretary of the Treasury. As provided by the law, the Secretary of the Treasury acts as Chairman of the Board of Directors. The Bank's management functions are performed by employees of Treasury's Departmental offices; its legal counsel is Treasury's General Counsel; and, its accounting operations are conducted by Treasury's Financial Management Service (FMS). The Bank reimburses Treasury for facilities and services.

NOTE 2 - LOANS RECEIVABLE

Loans receivable include agency loans purchased, loans to nonfederal entities, the repayment of which is guaranteed by an agency, and direct loans to agencies. Agency loans purchased are either notes or pools of loans sold by federal agencies in the form of certificates representing shares of ownership in the loan pool. The selling agencies guarantee the principal and interest repayments on the notes or certificates. Loans to nonfederal entities are loans made to nonfederal borrowers whose obligation to repay the principal and interest is guaranteed by a federal agency. Direct loans to agencies are debt securities issued to the Bank by agencies that are authorized by Congress to borrow to finance their activities.

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FEDERAL FINANCING BANK
NOTES TO THE COMBINED FINANCIAL STATEMENTS

NOTE 2 - LOANS RECEIVABLE (cont.)

Loans receivable consists of the following:

	September 30, 1992	September 30, 1991
	(in thousands)	
Agency loans purchased:		
Farmers Home Administration U.S. Dept. of Agriculture (USDA/CBO)	$42,979,000	$50,694,000
Medical Facilities, Dept. of Health and Human Services (HHS)	64,295	73,773
Health Maintenance Organizations (HMO)	59,656	66,029
Rural Electrification Admin. (USDA/CBO)	4,598,907	4,663,907
Small Business Administration Local Development Companies	4,517	6,883
Total agency loans purchased	47,706,375	55,506,596
Guaranteed loans to nonfederal entities:		
Defense Security Assistance Agency	4,344,273	4,399,970
General Services Administration	858,533	730,949
Guam Power Authority, Dept. of the Interior (DOI)	26,995	28,405
Community Development Block Grants Dept. of Housing and Urban Development (HUD)	174,443	206,536
Low Rent Public Housing, HUD	1,853,216	1,903,403
Spacecom, National Aeronautics and Space Administration	0	32,673
Ship Leasing, Dept. of Defense, Navy	1,576,155	1,624,427
Rural Electrification Administration, Rural Utilities	18,142,977	18,396,947
State/Local Development-503, SBA	633,695	688,297
Small Business Investment Corp., SBA	143,414	245,049
Seven States Energy Corp., TVA	2,416,769	2,447,051
Student Loan Marketing Assoc., Dept. of Education	4,820,000	4,850,000
Virgin Islands, DOI	23,727	24,521
Washington Metro Area Transit Authority, Dept. of Transportation (DOT)	177,000	177,000
Railways 511, DOT	19,077	21,292
Rhode Island Depositors Economic Protection Corporation	125,000	0
Total guaranteed loans to nonfederal entities	$35,335,276	$36,174,520

FEDERAL FINANCING BANK
NOTES TO THE COMBINED FINANCIAL STATEMENTS

NOTE 2 - LOANS RECEIVABLE (cont.)

	September 30, 1992	1991
	(in thousands)	
Direct loans to agencies:		
Export-Import Bank of the U.S.	$ 7,692,495	$ 11,260,999
Tennessee Valley Authority	7,175,000	11,875,000
National Credit Union Admin.	0	113,580
U.S. Postal Service	9,903,400	8,200,600
Federal Deposit Insurance Corp.	10,160,000	8,295,934
Resolution Trust Corporation (RTC)	44,535,877	62,882,372
Total direct loans to agencies	81,466,772	102,628,505
(Discount) premium, net	(4,860)	(5,495)
Total Loans Receivable (net)	$ 164,303,561	$ 194,304,124

NOTE 3 - BORROWINGS

The Bank finances its loan portfolio primarily by borrowing from the Treasury. Under the Federal Financing Bank Act of 1973, the Bank may, with the approval of the Secretary of the Treasury borrow without limit from the U.S. Treasury. At September 30, 1992, the Bank had outstanding advances owed to Treasury of $149.5 billion, with interest rates ranging from 2.881 percent to 16.894 percent, and maturity dates from October 1, 1992 to December 31, 2026.

Additionally, the Bank had outstanding borrowings of $15.0 billion from the Civil Service Trust Fund, which is administered by the Office of Personnel Management. These borrowings are at interest rates ranging from 8.75 percent to 9.25 percent, and with maturity dates ranging from June 30, 2003 to June 30, 2005.

NOTE 4 - LOAN PREPAYMENTS

Under the terms of the majority of the Bank's loans, borrowers may repurchase their loans at a price reflecting changes in the loan value. These changes generate premiums and discounts at the time of the repurchase.

Under the terms of the master promissory note between the Bank and the Treasury, the Bank may repurchase the loans from the Treasury in accordance with the terms of each loan. There is no financial effect on the Bank from the premiums/discounts derived from prepayments in accordance with contracted terms. For the years ended September 30, 1992 and 1991, borrowers paid $386.4 million and $1.3 billion in premiums and received $3 thousand and $0.2 million in discounts on loan prepayments in accordance with contracted terms, respectively.

FEDERAL FINANCING BANK
NOTES TO THE COMBINED FINANCIAL STATEMENTS

NOTE 4 - LOAN PREPAYMENTS (cont.)

Public Law 100-203, authorized certain borrowers having loans guaranteed by the Rural Electrification Administration (REA) to prepay their loans at par value (face value) up to a specified dollar limit. Also, Public Law 100-202 authorized borrowers in the foreign military sales program guaranteed by the Defense Security Assistance Agency (DSAA) to prepay at par loans meeting certain specific criteria. The legislation precluded the Bank from enforcing provisions in the loan notes which require the loans to be prepaid at their then current market rate, which results in the above discounts/premiums that are passed through to Treasury. However, these Congressional actions did not amend the terms of the contract between the Bank and the Treasury, and do not provide the Bank with rights to prepay its Treasury borrowing in ways other than under the terms of the agreement existing between the Bank and the Treasury. Therefore, the Bank must pay to the Treasury the unaltered contractual value of the loans in order to fully repay these loans to the Treasury. The difference between the amounts paid to the Bank and the amounts owed to the Treasury under the unaltered contracts resulted in a loss to the Bank.

In fiscal year 1992, there were no loans prepaid under the above mentioned provisions. For 1991, loans having a total principal value of $709 million for the REA and DSAA programs were prepaid. See schedule below for computation of debt prepayment premium liability and related loss.

Debt Prepayment Premium Liability

For the year ended September 30,

	1992	1991
Beginning Balance	$ 2,105,734,376	$ 2,063,442,781
Prepayment Loss	0	140,527,188
Principal Repayment	(48,538,433)	(59,290,186)
Total	2,057,195,943	2,144,679,783
Accrued Interest	5,583,545	0
Reverse Prior Year Accrued Interest	(0)	(38,945,407)
Total Debt Prepayment Liability	$ 2,062,779,488	$ 2,105,734,376

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FEDERAL FINANCING BANK
NOTES TO THE COMBINED FINANCIAL STATEMENTS

NOTE 4 - LOAN PREPAYMENTS (cont.)

Debt Prepayment Premium Loss

	For the year ended September 30, 1992	1991
Prepayment Loss	$ 0	$140,527,188
Interest Expense on Prepayment Loss*	86,717,628	132,843,403
Total Debt Prepayment Premium Loss	$86,717,628	$273,370,591

* Interest expense includes accrued interest of $5,583,545 for 1992.

NOTE 5 - COMMITMENTS AND CONTINGENCIES

The Bank has reported $164 billion of loans receivable and $3.3 billion of accrued interest receivable as of September 30, 1992. Almost all of the Bank's loans are to federal agencies or to private sector borrowers whose loans are guaranteed by a federal agency. When an agency has to honor its guarantee because a borrower defaults, that agency must obtain an appropriation or use other resources to pay the Bank. However, if an appropriation is not granted or federal agencies are not allowed to fund the losses by borrowing from the Treasury, and the Bank is legislatively required to absorb the debt the agency owes it, the Bank would incur a loss. Since the bank is unable to estimate the amounts of the probable losses which might result from default, no charge for contingencies against fiscal year 1992 income has been recorded.

NOTE 6 - SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

	For the year ended September 30, 1992 (in thousands)	1991
Cash received during the year from interest income	$15,715,597	$18,675,203
Cash paid during the year for interest expense	$15,512,297	$18,672,807

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FEDERAL FINANCING BANK
NOTES TO THE COMBINED FINANCIAL STATEMENTS

NOTE 7 - PRIOR PERIOD ADJUSTMENT

Prior period adjustments of $64,000 were made for the year ended, September 30, 1992, for previously unrecorded capitalized interest on GSA loan programs, Foley Court, Foley Square, and Foley Office Building.

A prior period adjustment was made in the 1991 fiscal year amounting to $29,055,162. The purpose of this adjustment was as follows:

• Debt prepayment penalty accrued in the 1988 fiscal year and paid in the 1989 fiscal year. The accrual amount of $29,175,890 was never reversed.	$ 29,175,890
• To reverse accounts receivable erroneously recorded twice. (1988 fiscal year and 1990 fiscal year)	(83,653)
• To correct an amount of accrued interest paid during the 1989 fiscal year, but not previously accrued.	(37,075)
	$ 29,055,162

Had all of these adjustments been made in the proper period, the balance for accumulated deficit would have been ($2,006,093) instead of ($2,035,231) for the year ended September 30, 1989, and ($2,084,595) instead of ($2,084,512) for the year ended September 30, 1990, and ($2,111,519) instead of ($2,111,583) for the year ended September 30, 1991.

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FEDERAL FINANCING BANK
NOTES TO THE COMBINED FINANCIAL STATEMENTS

NOTE 8 - ACCUMULATED DEFICIT

The liability for the principal amount of loan prepayments under the provisions of Public Law 100-202 as described in Note 4 above was $2,057,195,943 and $2,105,734,376 respectively for fiscal years 1992 and 1991. Due to the provisions of Public Law 100-202 pertaining to loan prepayments by the Rural Electrification Administration (REA) and the Defense Security Assistance Agency (DSAA), the Bank has incurred losses amounting to $86,717,628 for 1992 and $273,370,592 for 1991. There have also been loan prepayment losses in prior years. The recurring accumulated deficits incurred by the Bank are due to these losses. While the Bank has been able to make payments against the debt prepayment liability, it also had to pay the interest accruing on the liability. Currently, the Bank is retaining interest from borrowers equivalent to one eighth of one percent more than the rate that is due Treasury on a particular security. This is the sole income available to the Bank to cover its administrative expenses and payment of the debt prepayment liability and related interest.

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Auditor's Report on Internal Control Structure

GKW GREGORY K. WASHINGTON
CERTIFIED PUBLIC ACCOUNTANT

INDEPENDENT AUDITOR'S REPORT ON INTERNAL ACCOUNTING AND ADMINISTRATIVE CONTROLS

I have audited the combined financial statements of the Federal Financing Bank as of and for the years ended September 30, 1992 and September 30, 1991, and have issued my opinion thereon dated March 31, 1993. As part of my audit, I made a study and evaluation of the system of internal accounting controls to the extent I considered necessary to evaluate the system as required by generally accepted auditing standards and Government Auditing Standards issued by the Comptroller General of the United States. The purpose of my study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the Bank's financial statements, not to provide assurance on the internal control structure.

For the purpose of this report, I have classified the significant internal accounting controls into the following categories:

- automated data processing,
- borrowing,
- expenditures,
- financial reporting, and
- lending.

For all of the control categories listed above, I obtained an understanding of the design of the relevant policies and procedures and whether they have been placed in operation, and I assessed control risk.

The Bank's management is responsible for establishing and maintaining a system of internal accounting controls in accordance with the Accounting and Auditing Act of 1950 and the Federal Managers' Financial Integrity Act of 1982. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system of internal accounting controls are to provide management with reasonable, but not absolute assurance that (1) obligations and costs are in compliance with applicable laws, (2) funds, property, and other assets are safeguarded against waste, loss, and unauthorized use or misappropriation, and (3) assets, liabilities, revenues, and expenditures applicable to operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over assets. Because of inherent limitations in any system of internal accounting controls, errors or irregularities may

nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

The Bank evaluated its systems of internal accounting and administrative controls in accordance with the Federal Managers' Financial Integrity Act of 1982. In its Financial Integrity Act report for fiscal year 1992, the Federal Financing Bank reported that its systems of internal accounting and administrative controls, taken as a whole, provided reasonable assurance that the required control requirements were being complied with. I reviewed the report and considered its statements in conducting my study and evaluation and determining the nature, timing, and extent of my audit tests. The report did not identify any material weaknesses at the Bank.

I noted certain matters involving the internal control structure and its operation that I consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

My study and evaluation disclosed that the Bank had corrected the internal accounting control weakness discussed in the September 30, 1991 Report on Internal Controls regarding debt payment premiums not being properly classified. (See Federal Financing Bank's Financial Statements for the fiscal year ending September 30, 1991 dated April 21, 1992). However, the following internal control weaknesses still exist which I consider material weaknesses:

- **Cash transactions were recorded in the general ledger more than 30 days after the transaction had occurred.** Accounting personnel continue to record transactions in this manner. Daily transactions are batched to be recorded at the end of the month and therefore, consequently, posting to the general ledger normally occurs more than 30 days after the batch date.

- **A subsidiary ledger is not maintained for Small Business Administration/Local Development Corporation (SBA/LDC) loans.** FFB depends on the SBA/LDC to furnish information as to the amount of principal and interest due on loans. This relationship is outlined in the Transfer and Guaranty Agreement between FFB and SBA/LDC. FFB is currently revising their accounting system to furnish information on individual SBA/LDC loans.

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- **A subsidiary ledger in an acceptable format is not maintained for debt owed to Treasury.** The condition still exists with no progress toward correction. However, borrowing transactions and repayments of these amounts to Treasury were properly supported for the 1992 fiscal year.

- **Subsidiary ledgers and commitment ledgers are not adequately maintained.** The Loan Management and Control System (LMCS) still contains unreconciled beginning balances and is still in a parallel testing mode. However, considerable progress has been made to correct these balances according to FFB officials. I have not audited the LMCS and give no opinion or any other form of assurance on it as of September 30, 1992.

I refer you to the above mentioned report for details of these findings.

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level of risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

My consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, I believe none of the reportable conditions described above to be material weaknesses.

I also noted other matters involving the internal control structure and its operation that I have reported to the management of the Federal Financing Bank in a separate letter dated March 31, 1993.

This report is intended solely for the use of the Federal Financing Bank, the U.S. Department of Treasury and other Federal audit agencies and should not be used for any other purpose. This restriction is not intended to limit the distribution of this report which is a matter of public record.

MARCH 31, 1993
LANDOVER, MD

Greg K. Washington, CPA

GREGORY K. WASHINGTON, CPA

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Auditor's Report on Compliance With Laws and Regulations

GKW GREGORY K. WASHINGTON
CERTIFIED PUBLIC ACCOUNTANT

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

I have audited the combined financial statements of the Federal Financing Bank (The Bank) as of and for the years ended September 30, 1992 and September 30, 1991, and have issued my opinion thereon dated March 31, 1993.

I conducted my audit in accordance with Generally Accepted Auditing Standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, and contracts applicable to the Bank is the responsibility of the Federal Financing Bank's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, I performed tests of the Bank's compliance with certain laws, regulations, and contracts. However, the objective of my audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, I do not express such an opinion.

As part of my audit, I also reviewed and tested compliance with provision of the Federal Financing Bank Act of 1973 (12 U.S.C. 2281-2296; section 2 of the Federal Managers' Financial Integrity Act (FMFIA) of 1982 (31 U.S.C. 3512 (b) and (c)); and related regulations. In my opinion, the Bank complied with the terms and provisions of laws and regulations for the transactions tested that could have materially affected its financial statements. In addition, my review disclosed that the bank had corrected the instance of non-compliance regarding the Federal Managers' Financial Integrity Act (FMFIA) Review Report as disclosed in my September 30, 1991 Report on Compliance With Laws and Regulations. Accordingly, the Bank has completed a separate FMFIA Review Report for the year ended September 30, 1992 pertaining solely to the Federal Financing Bank.

The results of my audit indicate that with respect to the items tested the Bank complied, in all material respects, with the provisions referred to above. With respect to items not tested nothing came to my attention that caused me to believe that the Bank was not in compliance, in all material respects, with those same terms and provisions of laws and regulations.

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I also noted other matters involving the internal control structure and its operation that I have reported to the management of the Federal Financing Bank in a separate letter dated March 31, 1993.

MARCH 31, 1993
LANDOVER, MD

GREGORY K. WASHINGTON, CPA

Comments From the Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

November 8, 1994

Mr. Gene L. Dodaro
Assistant Comptroller General
U.S. General Accounting Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Dodaro:

This letter responds to the October 24, 1994 draft GAO report, B-258571, entitled "Federal Financing Bank's 1993 and 1992 Financial Statements." Treasury appreciates your review of the independent certified public accountants' opinion that the FFB's statements are fairly presented in all material respects in accordance with generally accepted accounting principles.

We agree with your conclusions regarding the $2 billion deficit carried on the books of the FFB. This deficit resulted directly from legislation that required FFB to accept loan prepayments by certain borrowers at book rather than market value. Unfortunately, the legislation did not appropriate funds to relieve FFB of its related indebtedness to the Treasury. While, as you state in your report, the Budget Enforcement Act spending caps make resolution very difficult, Treasury will continue to explore means to resolve this problem.

Regarding the recommendation that Treasury give one individual the responsibility and authority to oversee both the credit accounting and the administrative side of FFB, we are reviewing the current structure to determine the most effective means of meeting that objective.

See comment 1.

On Page 9, the draft report states:

> The fiscal year 1993 report on compliance with laws and regulations reported that FFB did not disclose internal control weaknesses in their annual report as required by the Federal Managers' Financial Integrity Act of 1982.

The draft report misinterprets the findings of the fiscal year 1993 auditor's report. The March 25, 1994 auditor's report on compliance with laws and regulations in fiscal year 1993 stated:

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> In our report on the Bank's internal control structure dated March 25, 1994, we identified two material weaknesses. These material weaknesses were not reported in the Bank's most recent FMFIA report dated December 22, 1992.

The March 25, 1994 auditor's report did not, as the draft GAO report implies, state that the Federal Managers' Financial Integrity Act of 1982 (FMFIA) required FFB to prepare and submit any FMFIA report. If it had, the auditor would have been in error. Instead, the March 25, 1994 auditor's report simply stated that the material weaknesses identified by the auditor in 1994 were not reported in what the auditor referred to as FFB's "most recent FMFIA report dated December 22, 1992."

In reporting on FFB's compliance with laws and regulations, the draft GAO report should not be focusing on what the March 25, 1994 auditor's report referred to as FFB's "most recent FMFIA report dated December 22, 1992." As a government corporation and instrumentality of the United States, FFB is not, strictly speaking, required to prepare and submit an FMFIA report.

Instead, FFB is subject to those provisions of the Chief Financial Officers Act of 1990 (CFO Act) which are applicable to government corporations. Therefore, the draft GAO report should focus on the fact that the "management reports" prepared and submitted by FFB for fiscal years 1992 and 1993 under the CFO Act did report to the President and Congress the material weaknesses listed in the respective auditor's reports for those fiscal years.

Thank you for the opportunity to review and comment on the draft report.

Sincerely,

Gerald Murphy

Gerald Murphy
Fiscal Assistant Secretary
& Treasurer, FFB

The following is GAO's comment on the Department of the Treasury's letter dated November 8, 1994.

GAO Comments

1. We have considered Treasury's views and have revised the draft accordingly.